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C O N F I D E N T I A L SECTION 01 OF 02 BAKU 000531

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SUBJECT: AZERBAIJAN: ECONOMIC DEVELOPMENT OF THE EXCLAVE OF NAKHCHIVAN

REF: BAKU 502

Classified By: DCM Jason Hyland per 1.4 (b,d).

¶1. (C) Summary: During a March 28-29 trip to Nakhchivan, local officials provided a glowing review of economic growth and investment opportunities in the isolated exclave. According to Nakhchivan Ministry of Economic Development statistics, GDP grew by 27 percent in 2005, with a 57 percent increase in agricultural investment. Several new businesses have opened in Nakhchivan in recent years, including a new mining venture that has 49 percent U.S. ownership. Despite Nakhchivan's rosy economic forecast, which is driven largely by massive transfer payments from the central GOAJ budget and remittances from abroad, Nakhchivan remains a difficult place to do business. Foreign investment opportunities still seem to be limited mainly to companies with ties to Nakhchivan's powerful clans. Local officials also reported that Nakhchivan had not yet suffered avian influenza outbreaks. End summary.

¶2. (U) On March 28 and 29, emboffs traveled to Azerbaijan's exclave of Nakhchivan -- which is separated from the bulk of Azerbaijan by Armenian territory -- to explore Nakhchivan's economy, as well as its trade relations with Iran and Turkey (reftel). Emboffs met with the Nakhchivan Minister of Economic Development (MED), the Deputy Minister for the MED, the MED Head of the Apparat, the MED Director of Economic Policy and Planning Department and the MED Head of the Protocol Department, as well as the Turkish Consul General.

Background on Nakhchivan

¶3. (SBU) The exclave of Nakhchivan is approximately 5,500 square kilometers with an estimated population of 350,000. Local residents believe the actual population is around 175,000, as fully half of the exclave's population is believed to be working outside Nakhchivan. Its largest border -- 221 km with Armenia -- has been closed since the outbreak of the Nagorno-Karabakh conflict. Nakhchivan depends on borders with Iran (179 km) and Turkey (9 km) for access to the rest of the world. As part of its legacy as a former Soviet autonomous republic, Nakhchivan has its own government and constitution, though the exclave is heavily dependent on transfers from the GOAJ and remittances for its survival. According to the Nakhchivan MED and Embassy research, the central government in Baku transfers between USD 115-150 million to the Nakhchivan government each year, or nearly USD 430 for each person officially listed as living in the exclave. The Turkish and Iranian consulates are the only diplomatic representation in Nakhchivan. In general, Nakhchivan is a very isolated place, with its own culture and power structure. Former President Heydar Aliyev made his

political comeback in Nakhchivan, and the Aliyev family's connections there run deep.

Economic Indicators

14. (SBU) According to Nakhchivan's Minister of Economic Development, Famil Huseynov, Nakhchivan's infrastructure is expanding, and its local production continues to increase. He reported that over 70 percent of the population lives in suburban regions and there is a high demand for construction materials. As the government does not want the people within the exclave of Nakhchivan to feel separate or abandoned by Azerbaijan, the Government of Nakhchivan strives to meet Nakhchivanis' demands locally, without the aid of foreign assistance. Currently 70 to 80 percent of Nakhchivan's construction materials are produced locally, but Nakhchivan does import equipment from the outside. Nakhchivan has 16 production facilities, ranging from spaghetti, sausages and sugar to fruit and mineral water. Huseynov reported that in 2005, Nakhchivan experienced 27 percent GDP growth, general economic growth of 56 percent and a GDP per capita increase of 12.5 percent. Huseynov said that agricultural products investment grew by 57 percent, retail sales by 14 percent, financial services by 12 percent and foreign trade by 47 percent.

Future Economic Plans

15. (SBU) Huseynov hopes to maintain this growth in the future. The MED plans to create more jobs, give more incentives to small and mid-size businesses, allow for more production facilities, ensure consumer rights are protected,

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open up more local production facilities and explore modular power plants. According to Huseynov, the MED does not plan on exploring wind as a viable alternative energy source. (Comment: This position differs significantly from the Ministry of Energy and Industry's in Baku, which has pursued a USTDA-funded study of wind power for Nakhchivan.)

16. (SBU) According to Huseynov, in April 2006, Nakhchivan plans on opening a fruit drying facility, which will utilize German-made equipment. Nakhchivan also will open a food processing-juice producing plant, which will utilize Italian-made equipment and will use roughly 40 percent of the local harvest. Moreover, Nakhchivan will open a cigarette factory using local tobacco production as well as a marble production facility. In the spring of 2006, Politalin Company plans to open up a chemical plant which will manufacture Politalin. Lastly, Huseynov claimed that 75 percent of the furniture in Nakhchivan was produced locally.

Economic Opportunities for US Investment

17. (SBU) Huseynov suggested that there were business opportunities for foreign investment in exploring Nakhchivan's natural resources, such as salt, mining, agriculture, livestock, as well as shoe and concrete production. Embaffs visited the Azerbaijan Mining Operating Company (AMOC), a company that has 49 percent U.S. ownership under a production-sharing agreement. The gold-mining venture opened in August 2005 and employs 105 people (all but three of whom are local). AMOC intends on opening an ore producing plant in 2007 that will mine ore for gold, which will create an estimated 1,000 new jobs.

Avian Flu

18. (SBU) When embaffs queried Huseynov on avian influenza, he stated that up until 1993, Nakhchivan had three main poultry production facilities. Following 1993, these

production facilities closed; now over 70 percent of the rural population keeps chicken in their backyards. According to the Turkish Consul General, there was a human avian flu death not too far from the Nakhchivan-Turkey border, but there have been no confirmed human AI cases in Nakhchivan. He added that Turkey would undoubtedly provide assistance in the event of an outbreak in Nakhchivan. (Note: Nakhchivan borders the eastern Turkish regions that suffered an avian influenza outbreak in January. Reports from one U.S. NGO, the lone international NGO working in Nakhchivan, suggest that at least three areas of the exclave may have experienced mass bird deaths in January.)

Comment

19. (C) The touted economic growth in Nakhchivan is likely the result of the massive transfer payments from the GOAJ's central budget, as well as significant remittances from Nakhchivanis working abroad. Thus, the Nakhchivani officials' glowing economic forecast does not mean that there are likely to be many investment opportunities for U.S. companies. Unfortunately, Nakhchivan's isolated location and authoritarian government reinforce the message that all ills that beset mainland Azerbaijan's business climate exist, and indeed are magnified, in Nakhchivan. The exclave remains a singularly unattractive place for U.S. firms outside the extractive industries to do business, with a small market, high corruption, government interference, and limited commerce routes with the outside world. Doing business in Nakhchivan still requires extensive ties to the clans that dominate Nakhchivan's politics and economy. As a result, U.S. involvement in the AMOC deal is a bit of an anomaly; most observers believe the deal came through only because other companies with ties to the clan could not provide the large amount of investment required.

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